

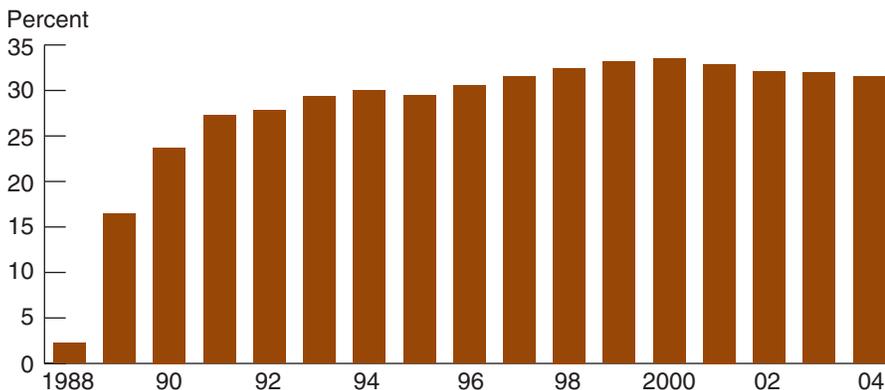
Introduction

The Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) provides supplemental foods, nutrition education, and health care referrals to low-income pregnant, postpartum, and breastfeeding women; infants; and children up to age 5 who are at nutritional risk. Over half of all infant formula sold in the United States is purchased through WIC. Federal law requires that WIC State agencies enter into cost-containment contracts for the purchase of infant formula. Typically, WIC State agencies obtain substantial discounts in the form of rebates from the infant formula manufacturers for each can of formula purchased through WIC.¹ In exchange for the rebates, a manufacturer is given the exclusive right to provide its product to WIC participants in the State. Contracts are awarded to the manufacturer offering the WIC State agency the lowest net wholesale price, as determined by the manufacturer's wholesale price minus the rebate.²

Infant formula rebates have become an important component of the WIC program, totaling \$1.6 billion in fiscal year 2004, an amount that supports about one-quarter of all WIC participants.³ The effect of infant formula rebates on reducing program costs has been significant. Since the establishment of the rebate program in the late 1980s, rebates as a share of total pre-rebate WIC food costs (i.e., costs before taking into account savings from the rebates) increased rapidly, peaking at 33.5 percent in fiscal year 2000 (fig. 1). In other words, WIC food costs would have been one-third higher at the same level of participation without the rebates. However, rebates as a share of total pre-rebate food costs have fallen each year since 2000 (down to 31.6 percent in 2004), as total WIC food costs increased faster than rebates. In recent years, some States awarding new infant formula rebate contracts have seen a marked increase in the net wholesale price for formula. This trend, if sustained, could have far-reaching negative implications for the WIC program. Therefore, understanding the costs to WIC of infant formula—and the factors behind costs—is important.

This report examines trends in the factors affecting WIC infant formula costs during the period January 1998-January 2006. The cost that WIC pays

Figure 1
Infant formula rebates as a share of total pre-rebate WIC food costs, fiscal 1988-2004



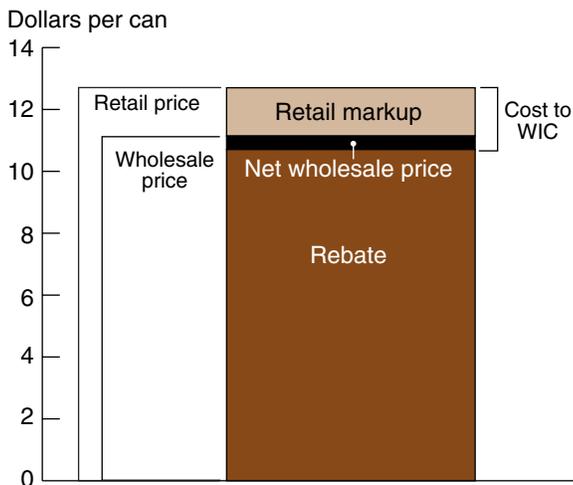
Source: USDA, Food and Nutrition Service.

¹Without the rebates, infant formula would be the most costly food item provided by WIC. Infant formula accounted for 44.1 percent of total WIC food costs before rebates in fiscal year 2003, but only 17.8 percent after rebates (FNS, 2006).

²The term “net wholesale price” is equivalent to the term “net price” used in previous ERS reports of the infant formula market by Oliveira et al. (2004) and Prell (2004).

³Estimate of the total value of rebates was provided by USDA's Food and Nutrition Service (FNS).

Figure 2
Relationship of infant formula rebate, net wholesale price, and retail markup for can of powdered formula



Note: Example based on a 12.9-oz can of Ross Similac with iron (powder) in the California WIC program during the 2nd quarter of 2004.
 Source: USDA's Economic Research Service.

for each can of formula provided through the program after rebate has two components: a part that goes to the manufacturer and a part that goes to the retailer (fig. 2). The part that goes to the manufacturer is referred to as the net wholesale price and is equal to the wholesale price minus the rebate. This is the part of the total cost to WIC that is the focus of WIC rebate bids and subject of most of the previous studies on WIC's infant formula rebate program.⁴ The second

cost component is retail markup, which has not received nearly as much attention. Retail markup is the part that WIC pays to the retailer (e.g., a supermarket or grocery store) and is equal to the retail price minus the wholesale price. Thus, the cost to WIC for each can of formula sold through the program (after rebate) can be expressed as:⁵

$$\text{Cost to WIC} = \text{Net Wholesale Price} + \text{Retail Markup,}$$

where

$$\text{Net Wholesale Price} = \text{Wholesale Price} - \text{Rebate}$$

and

$$\text{Retail Markup} = \text{Retail Price} - \text{Wholesale Price}$$

Information from several sources—including data on infant formula manufacturers' bids for rebate contracts, formula manufacturers' wholesale price lists, and scanner-based retail sales data from supermarkets—is used to address two major questions:

1. What are the recent trends in the infant formula rebates in terms of net wholesale price?
2. How much does the retail markup for infant formula affect the costs to WIC State agencies?

This study examines the cost of infant formula to the WIC program in light of recent changes in the infant formula market and in the program's authorizing legislation.⁶ It is the only study to examine rebates associated with infant formula in both liquid concentrate and powdered forms. Powdered formula has not been the focus of most previous studies, though it has become the most prevalent form of formula provided in WIC. This is also the first study to consider the impact of retail markups on costs to the WIC program.

⁴For example, see Government Accountability Office (2006), General Accounting Office (2003), and Center on Budget and Policy Priorities (1995).

⁵The cost of formula to WIC can also be expressed as retail price minus the manufacturer's rebate. Although this may be a simpler way of expressing infant formula's costs to WIC, this report retains the fuller expression in order to emphasize that costs to WIC are established by two different market agents—infant formula manufacturers and foodstore retailers.

⁶This study focuses solely on the infant formula provided through the WIC program that is covered by cost-containment contracts with manufacturers. The Government Accountability Office (2006) estimates that this includes about 92 percent of all infant formula provided through WIC. WIC does not receive rebates for the remaining 8 percent of infant formula provided to WIC participants, which includes exempt infant formula for use by infants with an unusual medical or dietary problem and non-exempt infant formula produced by a manufacturer not covered by the cost-containment contract. Local WIC agencies are required to obtain medical documentation to provide exempt and noncontract, non-exempt infant formula to program participants.